AN ELASTIC CURRENCY.

"GEORGE SMITH'S MONEY" IN THE EARLY NORTHWEST.

AN ADDRESS TO THE AMERICAN BANKERS' ASSOCIATION AT CHICAGO, OCTOBER 19, 1893.

BY

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AN ELASTIC CURRENCY.

Nearly everybody who busies himself with the subject of finance says that we ought to have an elastic currency. What is meant by that? Evidently it means a currency that will expand when there is an active demand for it and contract when the demand subsides. This suggests another query: What do we mean by demand? The demand for money is nearly universal. It is as great among the loafers around the City Hall as among the brokers on the Stock Exchange, but when we speak of the demand for money we do not mean the demand of either beggars or speculators. We mean the demand for money to carry on the exchange of the products of the country, which move at certain periods and years in larger volume than at other periods and years.

We all agree that the currency ought to be elastic in the sense of being more abundant when the exchanges of goods are rapid and extensive, and less abundant when the contrary condition exists. How can we get this kind of a currency? We cannot get it from the Government, because the Government cannot know when the demand for money is increasing and when it is diminishing. The Government has no commercial barometer. All of its machinery is political. The loafers around the City Hall have the same access to its ear as the merchants and the manufacturers. Tammany Hall has a stronger pull on it than the Produce Exchange. The advocates of a currency issued by the Government tacitly acknowledge these facts when they go in for a per capita currency. They have no measure for the needs of the community except a count of heads. They would not, however, apply this rule to the tribes of Central Africa. Why not? Because the business of Central Africa is not like our business. So it appears that the kind of business should be taken account of as well as the number of people.

That is all that we contend for. The Government has an infallible test for the numbers of the people, because it can take the census. But it has no test whatever for the state of business, except such inferences as may be drawn from the collection of taxes. I believe it has never been proposed to gauge the issuing of currency by the collections at the Custom House, but that method would be much more philosophical than the per capita method.

ALL TRADE IS BARTER.

Money is introduced to facilitate barter. The successive steps taken by mankind in order to reach the present trade conditions may be briefly enumerated, First, the products of different people were swapped for each other. Then a single species of property was taken as the measure of all other kinds, cattle, for example. Then various metals were successively used, iron, copper, silver, gold. But the march of civilization did not stop here. Bills of exchange came into vogue, and banks to balance them against each other. These bills constitute the bulk of what are known as bank deposits. The genuine bill of exchange represents goods ready for consumption, or materials destined to be converted into such goods and actually sold. Such goods and materials constitute the circulating capital of the country. They may be of domestic or of foreign origin, or of both. All the people may be considered, for the purposes of this discussion, as both producers and consumers. The exchanges which they make with each other constitute commerce, and the money problem is now, and always has been, how to effect these exchanges with the least amount of labor and cost.

BANK CHECKS AND BANK NOTES.

It was long ago perceived that the passing of gold from hand to hand was laborious and costly, and in most cases needless. Pieces of paper promising to pay gold came into use in the first place as labor saving machines merely, to avoid the trouble of carrying gold hither and thither. All Bank of England notes over and above the fiduciary issue of £15,500,000 are of this type, each one being a gold certificate of deposit. But other paper promises came into existence, which avoided not only the trouble of carrying gold, but also the cost of having it. These are bank notes, as we understand the term in the United States.

Nearly all persons know what bank checks are and what function they perform, but there is a certain mystery to the popular understanding about bank notes. There is no difference between the two things in their real nature. The butcher and the baker and the candlestick maker will accept their customers' checks on the bank because they consider them good, and sometimes their creditors will accept the same checks. If the public generally had the same confidence in me that they have in a bank, I might issue checks in the similitude of bank notes, and these checks would pass from hand to hand as long as there was a demand for currency. I might open a shop for the discount of commercial paper and give my checks to the parties whose paper I discounted, and these might pass into general circulation. A case of this kind occurs to me now.

"GEORGE SMITH'S MONEY."

There appeared in the village of Chicago, about the year 1834, a Scotch youth named George Smith, seeking his fortune like the other early settlers of the West. Mr. Smith had the banking instinct of his native country strongly developed, and he desired to exercise it in the new States and Territories adjacent to Chicago. Bank charters were scarce and hard to get at that time. None could be obtained in Illinois. Mr. Smith succeeded, however, in obtaining from the Territorial Legislature of Wisconsin in 1839 a charter for an insurance company. This was called the Wisconsin Marine and Fire Insurance Company. The charter contained powers for insuring against fire and marine disaster and also for insuring lives. It also authorized the company to "receive money on deposit and loan the same on *bottomry respondentia* or other satisfactory security. * * * Provided, nothing herein contained shall give the said company banking privileges." A subsequent clause provided that if the company should receive on deposit any bank notes, and lend them, it should endorse them by the signature of its President and redeem them in specie in case the issuing bank should fail. The act was passed February 28, 1839, and was to continue in force thirty years.

Although some of the functions of banking were embraced in the charter, the express prohibition of banking privileges meant that the company should not issue circulating notes. Nevertheless, Mr. Smith began almost immediately to issue certificates of deposit in the similitude of bank notes, and continued to do so until the General Banking Law of the State went into force in 1852. Here is a copy of one of them:

[Cut of harvester.]

[10] CAPITAL, $500,000 INCORPORATED 1839.

No. [Cut of Ceres.] 36420.

WISCONSIN MARINE AND FIRE INSURANCE CO.

This is to certify that *J. C. Bates* has deposited with this Institution TEN DOLLARS which will be paid on demand to bearer. Milwaukee, *June 3rd, 1850.*

Alex. Mitchell, Secy. *Geo. Smith*, Pres. [10]

The Wisconsin Marine and Fire Insurance Company started with a paid up capital of $8,104, its authorized capital being $500,000. It grew by slow degrees, through prudent management, to enormous success. Its certificates of deposit met a popular want. They were issued in denominations of $1, $3, $5 and $10. They were to be found in people's pockets all over Wisconsin, Illinois, Iowa, Missouri and Michigan, and were known everywhere as "George Smith's money." They eventually reached a circulation of $1,470,235. All this was before the day of railroads in the West.

Mr. Smith understood his business perfectly and omitted nothing to keep his institution in good credit. He not only redeemed the certificates at par in specie at the parent office in Milwaukee, but he established agencies at Chicago, Detroit, Buffalo, Galena and St. Louis, where he redeemed them in New York exchange, at the current rate. His success did not escape the notice of rivals. There were systematic runs on his institution for specie and they were always met with abundant bags of coin. These runs added to his fame and to the popularity of his money. The fact that his banking business was carried on without the sanction of law, if not in direct violation of it, was often discussed by those who had "George Smith's money" in their pockets. I often heard these discussions when I was a boy. They generally took this form: "Perhaps George Smith's bank is not according to law, but he can make more money by being honest than by being a rascal."

EFFORTS TO SUPPRESS SMITH.

The Legislature could not avoid taking notice of this exercise of "banking privileges" in the face of an express prohibition. At the Session of 1843 a committee was appointed to investigate the company. A report was made in the following year. The finances of the company were found to be in a sound condition, but it had issued upwards of $52,000 of certificates of deposit in the form and likeness of bank notes in violation of a clause of its charter. Consequently the committee recommended that the charter be repealed.

A few days later, Alexander Mitchell, the Secretary of the company, presented to the Legislative Assembly a letter protesting against a repeal of the charter and suggesting certain amendments to it. Subsequently, and while the report of the committee was still pending, he presented another communication denying the power of the Legislature to repeal the charter and contending that the company had been guilty of no violation of law. The question of violation of charter, he said, could only be determined by the courts. Both communications were referred to the Committee on Corporations, which presented a majority and a minority report. The majority sided with Mr. Mitchell and held that a court of law was the proper place to determine the question whether the charter had been violated, but it did not recommend the beginning of a suit to test the matter. The minority recommended a joint resolution ordering that such a suit be instituted at once. There was a rather exciting debate on the resolution, which was finally defeated by a majority of two.

In the year 1846 the Legislature repealed the charter by a decisive vote in both branches, but failed to pass a resolution instructing the Attorney-General to institute proceedings for forfeiture. The only notice that the company took of the repealing act was to issue a circular, saying: "The recent action of the Legislature of the Territory in reference to this institution will not in any way affect its rights or interrupt its business. This notice is deemed proper for the information and protection of the holders of its paper, which will be redeemed by its correspondents in New York, Buffalo, Detroit, Chicago, Galena and St. Louis, as heretofore." The circulation of the company had now increased to $180,372, and went on increasing with great rapidity till it reached the maximum sum already mentioned.

The company was reorganized under the Free Banking Law of Wisconsin, and when Mr. Smith retired from active business, as he did shortly before the war, Alexander Mitchell succeeded him as President. This renowned institution failed a few weeks ago, to the profound astonishment of all who remembered George Smith, whose name was and still remains a synonym for solvency throughout the Northwest. I met Mr. Smith at the Reform Club, in London, a few years ago, where he is still living, and where he is known as "Chicago Smith," to distinguish him from other representatives of that numerous family.

SIMILARITY OF THE CHECK AND THE NOTE.

I could detain you a long time with matters of interest touching "George Smith's money," which afterwards included a bank in Georgia as well as the reorganized insurance company in Wisconsin, but the point I wish to illustrate is that a check on a bank, or a private individual's acceptance, or a certificate of deposit in an insurance company, or any kind of shinplaster, will perform all the functions of a bank note, if the public have the same confidence in the issuer. There is no difference between the check and the bank note as regards their intrinsic nature and character. Both are orders on the bank payable on demand. The bank note circulates more widely than the check because the credit of the bank is better known than that of private individuals who draw checks, and because greater precautions have been taken against forgery and counterfeiting. During the past thirty years additional and absolute credit has been given to bank notes in this country by the Government's guaranty. It is customary to say that the noteholders are secured by a pledge of United States bonds. The fact is that they are secured by the Government's guaranty, and the Government itself is secured by four different cumulative funds, viz.: (1) Government bonds, (2) the 5 per cent. redemption fund, (3) a first lien on the bank's assets, (4) a first lien on the shareholder's liability. The noteholders need never wait a moment for the conversion of any of these assets into cash, because the Treasury is required by law to redeem all National Bank notes on presentation, whether the banks are solvent or insolvent. I hope that we shall never see any less prompt and infallible redemption of bank notes in this country, I have said that the bulk of bank deposits consists of paper representatives of the circulating capital of the country. This property passes from hand to hand by means of checks and bank notes. We may say that when sugar and flour, for example, exchange for each other by the car-load they exchange by the medium of bank checks and when they exchange by the barrel or the pound, they exchange by the medium of, bank notes. It is the difference between wholesale and retail.

AN ELASTIC CURRENCY.

A perfectly elastic currency would be one which should rise and fall in volume *pari passu* with the quantity of sugar, flour, cloth and other commodities seeking to be exchanged for each other. There are large sections of the country where banks do not exist, and where, consequently, bank checks could not be made available. Therefore wholesale transactions as well as retail ones in the great farming and planting, mining and lumber regions must needs be carried on with currency which passes from hand to hand, and remains in people's pockets for considerable periods of time. All the business that is done by means of bank checks can be accommodated as well at one time as at another, for the reason that checks do increase and decrease as deposits increase and decrease. This increase and decrease is largely automatic, but, not entirely so, because the intervention and volition of the banks are necessary to a perfect working of the machinery. For example, a wheat buyer or a cotton buyer wants ten thousand dollars to be employed immediately in moving the crop in his neighborhood. He makes his note at the bank or offers for discount a draft on his Eastern correspondent secured by a bill of lading. The bank discounts his paper and the amount is immediately credited to him as a deposit, and will be drawn mostly in the form of bank notes to be disbursed among the farmers. Take another case. Manufacturer A makes a hundred cases of shoes which he sells to Merchant B on three months' time. A takes B's note or acceptance at three months, gets it discounted at his bank, and the amount is immediately credited to him as a deposit. This will be drawn chiefly in the form of checks, because shoemaking is done in a city. The checks will be drawn to pay for leather and other materials used in the shoe trade, but a certain amount will be required in the form of bank notes to pay the wages of workmen. The checks will balance other checks at the bank or the Clearing House. In each case it will depend on the volition of the bank whether the draft shall be discounted or not; but, as this is what the bank exists for and derives its income from, it will, in ordinary times, discount all of such paper that is offered to it by its regular customers. It is able to do so because each discount is a deposit, and because the checks drawn against deposits are met by the maturing acceptances. It is easy to see that the check system is automatic and elastic, and that it accommodates itself to the volume of business at one time as well as at another. It is not quite so easy to see that the bank note system may be automatic and elastic in the same way.

Now, our problem is to devise a system where the bank note shall be elastic like the check, and in like manner make barter a science. We can see now, if not before, why the Government has no facilities for imparting elasticity to the currency. It has neither the requisite knowledge of the needs of business nor the means of responding to them. Even if it had an oracle to keep it informed of the needs of business, it would have no means of putting the money where it is needed, unless it should go into the business of discounting commercial paper, in which case it would have to receive deposits also and perform the other functions of a bank.

ADVANTAGES OF BANK NOTES.

Returning to "George Smith's money," which played so large a part in the early settlement of the Northwest, it is obvious that the currency which he issued took the place of other kinds of money, and especially of specie, for which the products of the country would otherwise have been sold. On condition that the currency should always be redeemed in specie this was a good thing for the holders of Smith's money as well as for Smith; that is, it was an advantage to the public. It was an advantage because it was more convenient to handle and carry and count, while it performed all the local exchanges equally well. It introduced the principle of barter on a large scale. Whatever work bank checks would do in the City of Milwaukee George Smith's money would do over the greater part of Wisconsin, Illinois, Missouri and Iowa. It enabled the local exchanges to be carried on without specie. Exchange on New York was supplied by Smith at something less than the cost of sending gold.

A SAVING OF CAPITAL.

There was another advantage in the use of George Smith's money. There was a painful want of capital in the Northwest at that time. If the community had been obliged to buy gold for all the purposes of local trading it must have parted with capital for this purpose. So there would have been less capital available for other uses. Let us trace the course of any given sum of George Smith's money, say $10,000. He lends this sum to a wheat buyer, who disburses it among farmers, who pay it out to country store-keepers, to farm laborers, teamsters, school teachers, clergymen, doctors, etc. By and by it gets into the hands of the city merchant who needs to make remittances to New York and Boston. He takes the notes to Smith and gets drafts on those cities at the current rate of exchange. It is of no use for him to draw gold for the notes because he cannot send it to New York and Boston as cheaply as he can buy Smith's drafts. Smith keeps no more gold on hand then the amount that will probably be called for. The difference between this amount and the amount of his outstanding currency is a saving to the region where the currency circulates.

You will ask, Who gets the profit? First, Smith gets it, but he does not get all of it. The farmers would have received gold for their wheat if they had not taken Smith's notes, but they would have been obliged to wait till the wheat could be sent to the Eastern market and the proceeds returned, or if they did not wait somebody must, and this somebody must needs be reimbursed out of the crop for waiting.

Again, if the proceeds of the crop came back in gold, it could not come back in the form of ploughs, axes, nails and other goods, this being the preferable form. Of course, the time would come when the country would be saturated with gold, so that no more need be imported, but the progress of the community would be retarded and its comfort lessened by the withdrawal of capital for this purpose. So you see that while Smith's profits were large, indeed disproportionately so, he did not alone reap the advantages of a paper medium of exchange, which was sound in fact although unsound in principle. It was sound in fact because Smith was a genius in his profession. It was unsound in principle because it was not accompanied by safeguards to protect the public against knaves and fools. Of these the Northwest had a large experience after Smith had retired at the age of 50 to his native land with a fortune estimated at ten million dollars, which was at that time not exceeded by more than three in the United States, and not a dollar of which had been gained by dishonest means. How much money Mr. Smith might have made if he had continued in business till this time, I tremble to think. Being a bachelor of frugal habits he probably thought that ten millions was enough. I commend him to all here present as an instance of moderation. The stoic philosopher Seneca is hardly a more shining example.

NO LIMIT TO GOOD BANK NOTES.

George Smith's money was an elastic currency. There was no limit to his issues because they were all alike illegal. Being without limit he discounted all the paper that he considered good. He could do this because as much was running off as was coming in. He gave his own paper payable on demand for that of merchants payable at a fixed time. His own paper passed from hand to hand and might stay out a whole year. In the fall, when the crops began to move, there was no lack of money for legitimate trade, because it was as easy to put out these certificates at one time as at another. In the winter, when lake navigation was closed the certificates answered all the purposes of a local circulating medium. In the spring, when the steamboats began to move, bringing new settlers and cargoes of goods, the certificates came back to headquarters mainly for the purchase of New York drafts, after which they took their usual round again. These New York drafts were a part of the general system of barter on a large scale.

I have said that under the George Smith régimé there was abundance of money for legitimate trade. This means simply that for the purpose of bartering the consumable products of the country against each other there was no lack of instruments of exchange. It is not a banking function to furnish capital for the building up of a new country or for permanent works of any kind. Most of the misfortunes that have overtaken banks in this country have resulted from loans to speculators, such as advances to railway builders, to real estate owners and the like. No currency will ever be elastic enough to satisfy such wants. Suppose that the strongest bank in New York should undertake the building of hotels as a part of its regular business. How long do you think it would be the strongest bank, or any bank at all? Every prudent depositor would draw his money out because he would know that hotels are not quick assets. They cannot be realized on in sixty or ninety days.

NATIONAL BANK CURRENCY NOT ELASTIC.

I think that everybody who has followed this discourse, which is largely a narrative of facts familiar to many of you, must see what are the elements and requisites of an elastic currency. These requisites, are first, that there must be no limit set upon it, except the demand for instruments with which to exchange the consumable products and materials moving through the country, including such as have been imported from, or are going to, foreign countries; second, it must be issuable at once, as the demand for it arises, without waiting for somebody else to do something else, and without spending more money in making preparations for it than is finally obtained. The present National Bank currency is not and never was an elastic currency. It has great and abounding merits, but elasticity is not one of them. Of late years it has been losing such elasticity as it had in the beginning. Instead of expanding with the wants of trade it has been contracting in the face of them. The recent increase is spasmodic, being due to a wholly abnormal condition of business.

CAN BOND SECURITY BE DISPENSED WITH?

The great merit of the National Bank currency is its security. This is due to the Government's guaranty, which in its turn is justified by the four separate funds already enumerated, viz.: United States bonds, the 5 per cent. redemption fund, the first lien on assets and the first lien on shareholders' liability. The Government's guaranty is always sufficient for the noteholders. The question is, whether United States bonds can be dispensed with as part of the security of the Government. In a former discourse I gave reasons for the belief that with a small tax on bank notes, to be accumulated as a safety fund, something like the old New York Safety Fund, the bond security could be safely dispensed with. Shortly after that discourse was delivered the Comptroller of the Currency, Mr. Hepburn, replying to an inquiry of the Hon. Michael D. Harter, wrote the following letter:

(Copy.)

"TREASURY DEPARTMENT,
"OFFICE OF THE COMPTROLLER OF THE TREASURY,
"WASHINGTON, Feb. 24, 1893.

"Hon. MICHAEL D. HARTER, House of Reps., Washington, D. C.

"Sir: I have the honor to acknowledge the receipt of your letter of the 23d instant. In answer you are respectfully informed:

"1st. That you are correct in understanding from my letter of the 21st inst. that the taxes upon circulation paid by the National Banks to the Government, since the organization of the system in 1863 to the end of the last fiscal year have aggregated \$72.635,000 in amount; that the entire expenses of the United States growing out of the National Banking system during the same period have amounted to \$14,585,000, showing a net profit to the United States up to June 30, 1892, of \$58,050,000, and that the Government during the same period has, by other forms of taxation, received from the banks \$72,143,000, giving the United States a total net profit from the National Banking system to June 30, 1892, of \$130,193,000.

"You are also correct in the understanding that if the banks had never given to the United States bonds as collateral security for their notes, but instead a first lien upon the assets, the United States would, up to June 30, 1892, have lost but \$953,667, still leaving to the United States a clear net profit arising from the taxation of National Bank notes alone of \$57,096,333.

"2d. In ascertaining the loss which the Government would have sustained up to June 30, 1892, growing out of the liability to pay the holders of National Bank notes in full in the event that the Government had at no time required the National Banks to deposit bonds to secure circulation, and had in lieu thereof received a first lien on all the assets of such banks, I have included the sums received by assessment of the stockholders of failed banks, and the proceeds of the bonds deposited with the United States to secure circulation to the extent of the excess of such bonds over the circulation secured by them. Under these circumstances the loss which would have resulted to the Government from the insufficiency of the assets of insolvent National Banks to pay the outstanding circulation would have amounted to \$953,677 on June 30, 1892, as stated in my letter of the 21st inst. Yours respectfully,

"A. B. HEPBURN, *Comptroller*."

It appears, therefore, that if there had never been any bond security for National Bank notes the Government would have lost less than a million dollars by redeeming the notes of all failed banks. To put it in another way, if there had been a common fund of something less than a million dollars accumulated by taxation of bank notes no loss would have resulted to the Government. This fact speaks volumes for the carefulness of the National Banking Law itself and for the carefulness with which it has been administered. I have the highest admiration for both. The astonishing record which Comptroller Hepburn has here presented is due to Governmental supervision and inspection of the assets and liabilities of the banks. If a bank's assets are all right its liabilities of every name and nature will be properly met. Under the old free banking system, as it existed in the West, exclusive attention was given to security for circulating notes. The law said virtually to the banks : "Give us bond security for your notes and then you may go to the devil." When the bond security went to that destination it was found that the banks had already preceded them thither. The doctrine of *laissez faire* does not apply to banks, and least of all when they are invested with the power of issuing circulating notes.

THE SCOTCH BANK NOTE SYSTEM.

Bond security for bank notes is not consistent with elasticity. If you ask me whether I consider elasticity a more valuable feature than security I say decidedly not. Our aim should be for both security and elasticity. Both are attained in the Scotch system by unlimited liability of the shareholders of banks for their note issues. Formerly the liability of shareholders of all the banks except three was unlimited as to all claims whatsoever, but since the failure of the City of Glasgow Bank and largely in consequence of it, the unlimited liability clause has been repealed, except as to note issues. Thus it has happened that the notes of failed banks in Scotland have always been received by the other banks at par and have never depreciated, although they had neither bond security nor safety fund behind them. It is an interesting fact that when the Territorial Legislature of Wisconsin was considering the question of repealing the charter of George Smith's marine and fire insurance company, he proposed an unlimited liability clause as an amendment to it, which would be acceptable to the company. So you see that a safety fund is not the sole alternative to bond security. Probably a safety fund would be preferred in this country by bank shareholders, rather than unlimited liability for note circulation, because unlimited liability has a very threatening sound.

NOTEHOLDERS' FIRST LIEN ON BANKS' ASSETS.

Occasionally some man starts up and asks why noteholders should have a first lien on the assets of a failed bank, and why a preference should be given to them over depositors. There are three classes of creditors of a failed bank : noteholders, depositors and shareholders. The two latter have deliberately chosen the place where they will put their property, and the depositors exercise that choice freely from day to day. Noteholders, as a general rule, exercise no choice whatever, for although bank notes are not legal tender, they cannot be refused in practice after the law has authorized their emission, so long as the issuing bank keeps its doors open. This is the reason why nearly all the banking laws in this country, and many of the State constitutions, make the circulating notes a first lien on the assets. Under the National Banking Law, as I have said, the Government guarantees the notes and then secures itself in four different ways. The following clause in Section 5230, Revised Statutes, describes one of them.

"For any deficiency in the proceeds of all the bonds of an association when thus sold, to reimburse to the United States the amount expended in paying circulating notes of the association, the United States shall have a paramount lien upon all its assets, and such deficiency shall be made good out of such assets in preference to any and all other claims whatsoever except the necessary costs and expenses of administering the same."

GOLD RESERVES AND REDEMPTION.

If a bank note system is both elastic and secure we have every requisite of a perfect system. What we mean by security is the convertibility of the bank note into gold on demand. We have been learning in recent years how small an amount of gold is needed to maintain the gold standard in a country which is not obliged to keep a war chest. Fifteen years ago we accumulated one hundred millions of gold to guarantee redemption of about three hundred and fifty millions of greenbacks. This was the proportion which prudent financiers judged to be necessary. The redemption fund was about 30 per cent. of the paper to be redeemed. Well, we have gone on from that day to this adding to our stock of fiat money, partly silver dollars, partly Treasury notes, till we have piled six hundred millions on top of the original three hundred and fifty millions. We have now nearly one thousand millions resting on the original gold reserve, the redemption fund being only 10 per cent. of the fund to be redeemed. I acknowledge my own surprise at this outcome. It is only within four or five months that signs have appeared in the financial firmament that the limit of fiat money that can safely rest on one hundred millions of gold has been reached. I only regret that this additional circulation, for which we see there was a real demand, was obtained at such a costly rate by the purchase of silver bullion, whereas the public might have been more easily and accurately served with bank notes, which cost nothing but the printing—as the Northwest was served with George Smith's money back in the forties, but in a more orderly way. I say bank notes, not Government notes, because I hope to see the Government go out of the banking business altogether. Another reason why bank notes are preferable is that they are continually balancing each other in the trade of the country, just as checks do. In other words they redeem themselves without the use of gold. Gold is needed as a touchstone all the time, but its actual transfer is required only to settle balances of international trade.

BANK CONSOLIDATION.

A third way to dispense with bond security for bank notes would be by bank consolidation or by making one bank so large that it could not fail, like the Bank of England, the Bank of France, or the Imperial Bank of Germany, and making it the sole issuer of the currency. The three banks I have named are not all on the same plan. They differ in material respects, but they are alike in one particular. They are so large and are charged with such weighty responsibilities that their notes are always safe. They may at rare intervals suspend specie payments, as the Bank of France did during the war of 1870, but temporary suspension is not such a terrifying fact as it once was. It is hardly possible nowadays that any one of the three banks named should suspend in time of peace. There is a strong public feeling against a new Bank of the United States, and this prejudice is not wholly unfounded. The monopoly of note issues enjoyed by the Bank of France would not be tolerated in this country; yet the foremost consideration in banking science is solvency. The more capital a bank has the more likely it is to remain solvent. When any financial flurry comes, the little banks of $50,000 capital topple over first. The large ones, unless they have been speculating—*i. e.*, doing something else than a banking business—survive, simply because of their heavier ballast.

BRANCH BANKS.

There is no reason that I can discover why the National Banks should not be allowed to have branches, as the Scotch banks and the Canadian banks have. The old State Bank of Indiana (*clarum et venerabile nomen*) which was contemporaneous with George Smith's institution and a greater success even than his, consisted of thirteen branch banks, all pledged for each other and under each other's watch and ward. This institution passed unscathed through the two severest panics the country ever saw. Why should we not allow the large banks in the cities to annex the little $50,000 concerns that topple over so easily, or to establish others of that size where they are wanted? They will all be stronger, on the same principle that a bundle of sticks is stronger than the same sticks taken separately.

UNITED STATES BONDS A VANISHING QUANTITY.

One way or another, gentlemen, the bond security clause of the National Banking Act must be got rid of before you can have a flexible currency. We are spared the necessity of further argument on this point because the bonds of the United States are disappearing. There has been a temporary stoppage of bond redemption by reason of the increase of pension payments and the decrease of revenue, but that condition is altogether abnormal. Pension payments will decrease and revenue will increase, through natural causes. It is a safe prediction that the present bonded debt will not outlast the term of its maturity in 1907. It is high time, therefore, to be thinking about something else. Don't think about railroad and municipal bonds as a substitute. The country had that pestilence before the war.

STATE BANK NOTES.

It also had the pestilence of State Bank notes. Not all of these were bad. Indeed, there were more good ones than bad ones, but the peculiarity of that system was that it took its reputation from its bad ones and not from its good ones. So, the public was all the time on the lookout for the bad ones, as a cook is for suspicious eggs, but with the difference that a bad egg always proclaims itself, while a bank-note does not. So it would be under any revival of that system. Imagine forty-four States sending out bank notes under forty-four different banking laws. Who would be able to know anything about their goodness? You might as well play forty-four games of chess simultaneously with your back to the table. And let me ask this question: If bond security were dispensed with and its place taken by any one of the three alternatives I have mentioned, viz., safety fund, unlimited liability or bank consolidation, what could the States do for banks that the National Government could not do better? They could not make banking easier, except by relaxing vigilance, supervision, examination; that is, by exposing the public, both depositors and noteholders, and shareholders as well, to depredation.

We are told that we need a currency that will stay in the places where it is issued If that is a desideratum, make a provision of law that no bank shall pay out any notes but its own. I think that is a sound principle, and that it would help to make an elastic currency. This principle was embodied in the laws of Massachasetts and of Louisiana before the War, two of the soundest banking systems that this country or any country ever had. If no bank pays out any notes but its own there will be no motive to send the local currency away, because when remittances are to be made the issuing bank will sell drafts, as George Smith did, at lower rates than could be made by shipping currency.

CONCLUSION.

Now, gentlemen, my last word to you is this. In the realm of sound banking there is no more reason for a shortage of currency any year, or any time of the year, than there is for a shortage of bank checks. The nature of the circulating note and of the check is the same. Both are orders on the bank for money, or money's worth. The true fund for the redemption of the bank's notes is the bank's assets; that is to say, its bills receivable. The existence and *bona fide* character of the bills receivable should be a matter of public concern, as it is under the National Banking Law. It is no hardship to a bank to be frequently examined by public officers, and nobody will ever complain of such examination except wrongdoers. The persons most vitally interested in the thoroughness of such examinations are the bank's shareholders, since they are the only persons concerned who can lose more than they have put in. Bear in mind, also, that the more rigid and intelligent these examinations are, the less of other security will be needed for the protection of noteholders, and the less gold. Your gold reserve must be big in proportion to the badness of your banking system, not to its goodness.

I shall append to this discourse a copy of a bill for a safety fund to take the place of bond security, which I drew up last January, at the request of the Hon. Joseph H. Walker, of Massachusetts, and which he introduced in the House of Representatives. Although, as I have said, I do not consider this the only feasible plan for replacing bond security, perhaps not the best one, I am convinced that it is a safe plan. At all events, it will furnish a basis for public discussion, which must precede any change in our present system. You will understand, of course, that this bill does not, in any way, change the present National Banking law, except as to bond security.

A BILL to Create a Safety Fund for the Redemption of the Notes of Insolvent National Banks.

Be it enacted, etc.: SEC. 1. That the proceeds of the duty of one-half of one per centum each half year required to be paid to the Treasurer of the United States by National Banking Associations on the average of their notes in circulation, shall be retained as a separate fund in the Treasury, to be denominated the National Bank Safety Fund, until said fund shall not be less than   per centum of the whole amount of National Bank notes outstanding, and thenceforth the collection of said duty shall be suspended, except as hereinafter provided.

SEC. 2. The money in said Safety Fund shall be appropriated and applied in the manner hereinafter provided, to the payment and redemption of the circulating notes of any of said National Banking Associations which shall fail to redeem their notes on demand.

SEC. 3. Whenever the insolvency of any National Banking Association shall be ascertained in the manner provided by law, its outstanding circulating notes shall be redeemed by the Treasurer of the United States out of said Safety Fund if the same shall be sufficient, and if not sufficient, then out of any money in the Treasury. As the proceeds of its assets, including the personal liability of shareholders, if necessary, are paid into the Treasury by the Receiver, in the manner now directed by law, before any dividend shall be paid to depositors, or any other creditors of the bank, the Safety Fund shall receive a sum equal to the outstanding circulation of such insolvent National Bank, as far as the proceeds of such assets permit. If such proceeds are in excess of the amount required to redeem the circulation, such excess shall be divided among the depositors and other creditors in the manner now provided by law.

SEC. 4. Whenever the percentage of money in the Safety Fund shall be reduced, or shall become liable to reduction through bank failures, the Comptroller of the Currency shall notify the Treasurer of the United States of the amount which he deems necessary to make good such deficiency, and the Treasurer shall thereupon resume the collection of the duty of one-half of one per centum each half year on circulating notes until such deficiency or estimated deficiency is supplied. And the United States shall be paid out of said Safety Fund, when replenished, for all advances made in pursuance of the preceding section, together with interest at the rate of four per centum per annum.

SEC. 5. Whenever the amount of money in the Safety Fund shall be equal to one-fourth of the maximum sum prescribed in the first section, each of the Associations issuing circulating notes shall have the right to withdraw a portion of its bonds held by the Treasurer of the United States to secure its circulation, as nearly equal to one-fourth of its whole deposit as may be, in multiples of one thousand dollars; and with each successive increment of one-fourth of said maximum sum in the Safety Fund said Associations shall have the right to withdraw a like amount of such bonds in the manner and proportion aforesaid. When the Safety Fund contains the maximum sum prescribed in the first section, the said Associations may withdraw the residue of such bonds, provided, however, that each Association, whether issuing circulating notes or not, shall keep on deposit with the Treasurer bonds of the United States to the amount of not less than five thousand dollars at the par value thereof; provided, also, that any Association not issuing circulating notes and having more than the minimum of five thousand dollars in bonds on deposit may withdraw the excess over five thousand dollars at any time after the passage of this act. It shall be the duty of the Treasurer of the United States to transfer and assign to such Associations their bonds from time to time as they may be entitled to receive same in pursuance of this act.

SEC. 6. National Banking Associations organized after the passage of this act may receive circulating notes from the Comptroller upon paying into the Safety Fund the percentage fixed in the first section hereof, and existing Associations desiring to take out additional circulation may do so on the same conditions, but nothing in this act shall change the proportions between circulation and paid-up capital as now established by law. For all sums paid into the Safety Fund in pursuance of this section allowance shall be made in subsequent collections of the duty on circulating notes for said Safety Fund, until the payments shall have been equalized as nearly as may be among the Associations required to contribute thereto on the basis of their circulation, which equalization shall be determined by the Comptroller.

SEC. 7. No Association or individual shall have any claim upon any part of the money in said Safety Fund, except for the redemption of the circulating notes of insolvent National Banking Associations as herein provided. Any overplus or residue of said Safety Fund which may be hereafter ascertained and determined by law shall inure to the benefit of the United States.